

**Before the Committee on the Budget
Housing & Infrastructure Task Force**

U.S. House of Representatives

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**Maritime Administration:
Limited Progress In
Disposing of Obsolete
Vessels**

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Mr. Chairman and Members of the Task Force:

We appreciate the opportunity to be here today to discuss the Maritime Administration's (MARAD) program for scrapping obsolete vessels. We have identified this program as 1 of the 12 most pressing management issues in the Department of Transportation. The Department, the Administration, and the Congress face a challenge in determining how to dispose of MARAD's Fleet of old, environmentally dangerous vessels in a timely manner.

The current approach of selling obsolete vessels for domestic scrapping is not working. There is limited capacity in the domestic scrapping market and the Navy is paying contractors to scrap its obsolete warships while MARAD is asking contractors to pay to scrap its vessels. Further, MARAD has been constrained from selling vessels overseas for scrapping, although this had been a key market in the past.

MARAD will not meet the legislative mandate to dispose of its obsolete vessels by the end of fiscal year (FY) 2001 in a manner that will yield financial benefits. MARAD will need relief from those requirements. MARAD will also need authorization and funding for a program to pay for the disposal of obsolete vessels if it is to have the potential to significantly reduce the Fleet.

MARAD is pursuing a number of alternatives for disposing of its obsolete vessels, but because of capacity limitations, no one has the potential to significantly reduce the backlog of vessels in a timely manner. MARAD needs to develop a plan and take prompt action to dispose of all of its obsolete vessels.

Our statement is based on our March 10, 2000 report on the scrapping program. We will discuss three issues today:

- The environmental threats posed by MARAD's growing backlog of obsolete vessels;
- Key factors contributing to MARAD's inability to scrap vessels domestically; and
- The need for prompt implementation of a plan that prioritizes disposal of the "worst condition" vessels and identifies methods and milestones for disposing of all obsolete vessels in the Fleet.

Growing Backlog of Obsolete Vessels Is a Threat to the Environment

MARAD currently has 114 obsolete vessels awaiting disposal. This number has grown from 66 vessels three years ago. Moreover, the inventory of obsolete vessels awaiting disposal is continuing to increase, and is expected to reach 155 by the end of FY 2001.

MARAD maintains its vessels in the water at three locations – the James River in Virginia; Beaumont, Texas; and Suisun Bay, California. Environmental dangers associated with these old, deteriorating ships are increasing daily. The so-called “worst condition” vessels are about 50 years old and have been awaiting disposal for 22 years on average.

Vessels Awaiting Disposal at Suisun Bay Reserve Fleet

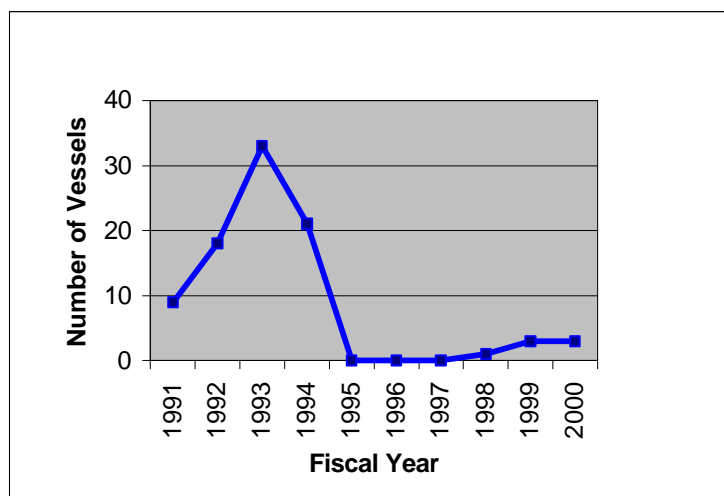


These vessels contain hazardous materials such as polychlorinated biphenyls (PCBs), asbestos, lead-based paint and fuel oil. Some vessels have deteriorated to the point where a hammer can penetrate their hulls. If the oil from these vessels were to enter the water, immediate and potentially very expensive Federal and state action would be required. For example, MARAD spent \$1.3 million on a costly environmental cleanup because one of the “worst condition” vessels deteriorated to a point where oil leaked into the water.

MARAD’s Inability to Scrap Vessels is Attributable to Several Key Factors

Since 1995, only seven vessels have been scrapped. This represents a significant change from 1991 through 1994 when 80 ships were sold overseas at an average price of \$433,000 per vessel. Recent sales to domestic scrappers have only yielded between \$10 and \$105 per vessel.

MARAD Vessels Scrapped



MARAD stopped selling vessels overseas for scrapping in 1994 due to Environmental Protection Agency (EPA) restrictions. In September 1998, the Administration placed a moratorium on **all** sales of vessels for scrapping overseas that remained in force through October 1, 1999. MARAD has continued to refrain from exporting obsolete vessels because of concerns about the environment and worker safety.

Since 1994, MARAD has been relying on the domestic ship scrapping market, but its capacity is limited. Only four companies have passed MARAD's technical compliance review to scrap vessels. Although MARAD sold 22 vessels to these domestic scrappers since 1995, 13 of the vessels are still in MARAD's Fleet. Recent contractor delays and a contractor default raise a question as to whether these vessels will be removed by contractors from the Fleet.

The Department of the Navy experienced a similar inability to sell its combatant vessels for domestic scrapping. In 1998, Congress authorized and appropriated funding for a pilot project allowing the Navy to pay domestic contractors to scrap vessels. On September 29, 1999, the Navy awarded four contracts amounting to \$13.3 million for the scrapping of four vessels.

MARAD cannot compete with the Navy pilot program in the limited domestic market because, by law, MARAD is prohibited from paying for scrapping services. The contractor that defaulted on MARAD, is scrapping a Navy ship under the pilot program.

MARAD Needs a Plan and Prompt Action To Dispose Of its Obsolete Vessels

While MARAD has been pursuing alternative ways to dispose of vessels, it is constrained by the legislative requirement to maximize financial returns. Also, the alternatives MARAD is pursuing have capacity limitations and, therefore, no single option has the potential to significantly reduce the backlog of vessels in a timely manner. These alternatives include: coordinating with the Navy and a west coast company on a proposal for a potential scrapping site; participating in interagency work groups to look for innovative ways to improve the ship scrapping process; and requesting approval from EPA to sell vessels to overseas markets.

The National Maritime Heritage Act of 1994 requires MARAD to dispose of its obsolete vessels by the end of FY 2001, which is an extension from 1999, the original deadline. MARAD does not have a plan to dispose of these vessels.

We recently recommended that the Maritime Administrator:

- (1) seek legislative approval to obtain an extension on the disposal mandate and eliminate the requirement to gain financial returns on vessel sales;
- (2) develop a proposal seeking authority and funding to pay domestic contractors to scrap vessels, and target the “worst condition” vessels for priority disposal; and
- (3) continue to pursue programs to improve scrapping sales and identify alternative disposal methods for its obsolete vessels.

In its authorization request for FY 2001, MARAD proposed a 5-year extension “to develop and **begin implementing** a plan to dispose of these vessels.” We do not believe it is acceptable to **begin** disposal within 5 years considering the condition of some of the vessels, the environmental risks, and the costs to maintain them. In our opinion, the legislation should require MARAD to develop a disposal plan and substantially dispose of these vessels **within 5 years**. Further, MARAD needs to identify viable disposal methods, set milestones, and target the “worst condition” vessels for priority disposal.

BACKGROUND

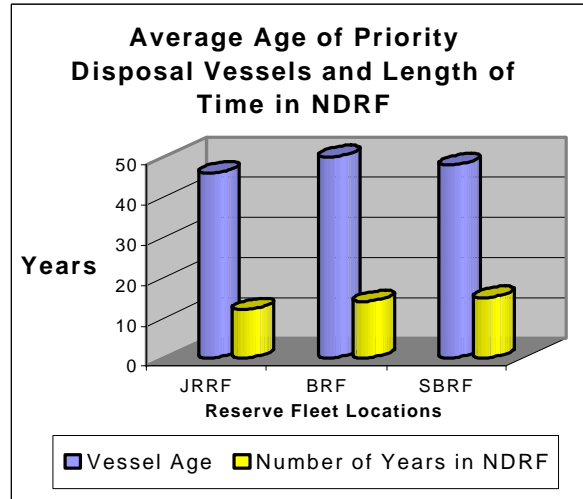
The Merchant Ship Sales Act of 1946 created the National Defense Reserve Fleet (NDRF), a Government-owned and administered Fleet of inactive, but potentially useful, merchant and non-military vessels to meet shipping requirements during National emergencies. MARAD administers the Fleet, and the Department of Defense provides the funding to maintain the Fleet. The Federal Property and Administrative Services Act gave MARAD responsibility for disposing of all Federal Government **merchant-type** vessels of 1,500 gross tons or more. The National Maritime Heritage Act of 1994 required MARAD to dispose of obsolete vessels in the Fleet by September 30, 1999, in a manner that *maximizes financial return to the United States*, but the Act was amended to extend the original disposal date by 2 years, from 1999 to 2001.

As of April 30, 2000, 114 obsolete vessels were designated for disposal because the majority of them are no longer operational. MARAD maintains the inactive vessels in the water at the following locations:

- James River Reserve Fleet (JRRF) at Ft. Eustis, Virginia (61 vessels);
- Beaumont Reserve Fleet (BRF) in Beaumont, Texas (9 vessels); and
- Suisun Bay Reserve Fleet (SBRF) in Benecia, California (42 vessels).

The Coast Guard holds two vessels in Mobile, Alabama for fire fighting training.

As shown in the following chart, the average age of the 114 obsolete vessels is 48 years. These vessels have been in the Fleet for an average of 15 years.



THE NUMBER OF OBSOLETE VESSELS AWAITING DISPOSAL IS INCREASING

The number of obsolete vessels has almost doubled since 1997. MARAD expects its inventory of obsolete vessels awaiting disposal will increase to 155 vessels by the end of FY 2001, as shown in the following chart.

Vessels Awaiting Disposal

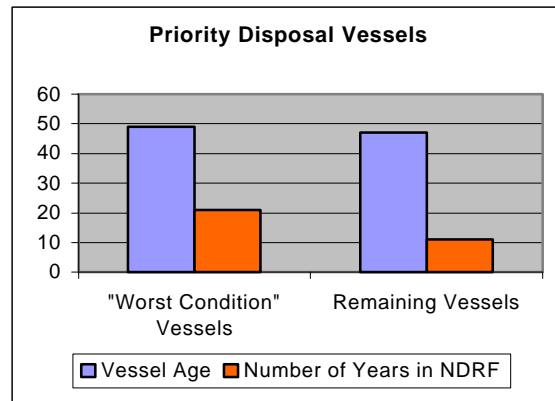
This projected increase is due to additional vessel transfers from the Navy, downgrades of other NDRF vessels to obsolete status, and the inability to sell ships for scrap. Of the 155 vessels, 132 will be targeted for scrapping. The remaining 23 vessels will be targeted for disposal through the fish reef program, use by a state or Federal agency, or held for useful parts and equipment. However, some of these vessels may be transferred into the scrapping category in future years if they cannot be disposed of through other means.

OBSOLETE VESSELS POSE ENVIRONMENTAL RISKS

The 114 obsolete vessels currently awaiting disposal pose environmental risks because they are deteriorating, contain hazardous materials, and contain oil that could leak into the water. These vessels are literally rotting and disintegrating as they await disposal. Some vessels have deteriorated to a point where a hammer can penetrate their hulls. They contain hazardous substances such as asbestos and solid and liquid polychlorinated biphenyls (PCBs). If the oil from these vessels were to enter the water, immediate and potentially very expensive Federal and state action would be required.

In 1999, MARAD identified the 40 “worst condition” vessels. These vessels were classified as “worst condition” due to their severe deterioration and threat to the environment. As of April 30, 2000, 3 of the 40 had been moved out of the Fleet to

domestic scrappers. As shown in the following chart, the “worst condition” vessels are older and have been in the Fleet longer than the other vessels awaiting disposal.



The “worst condition” vessels are in particularly bad condition, and may require additional or special maintenance. Our inspection of 11 of the original 40 “worst condition” vessels revealed corrosion, thinning, and rusting of the hull; asbestos hanging from pipes below deck; lead-based paint easily peeled from the ship; solid PCBs (in cabling); and in some instances, remnants of liquid PCBs in electrical equipment.

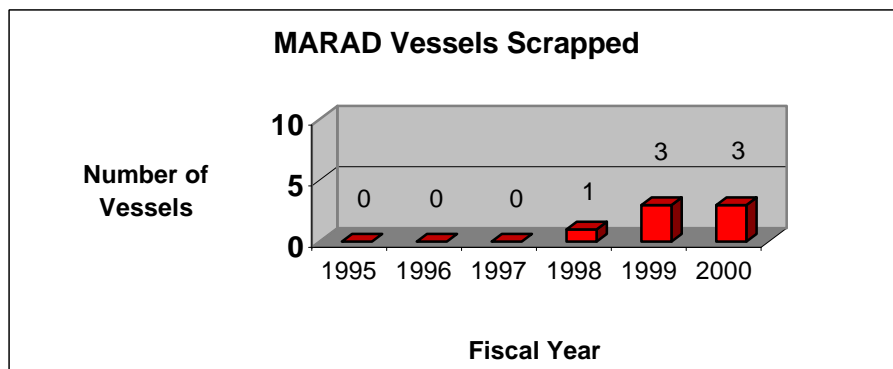
Deteriorating Vessel at James River Reserve Fleet



Costs to maintain these vessels will likely increase due to their deteriorating condition, leaks, and the need for additional time-sensitive maintenance. For example, MARAD spent \$1.3 million to maintain 1 of the 40 “worst condition” vessels over the past 2 years. This vessel is over 35 years old, contains hazardous substances including asbestos, and has deteriorated to the point where oil leaked into the water requiring costly environmental clean-up. MARAD has applied over 20 patches to leaks, removed hazardous materials, deployed containment booms, and pumped oil out of the vessel. The vessel is disintegrating to a point where it will not be seaworthy much longer. Monitoring efforts for this vessel are ongoing.

PROGRESS IN SCRAPPING VESSELS IS LIMITED

Although MARAD has sold 22 vessels since 1995, only 7 have been scrapped. Two other vessels have been towed to scrapping sites. The remaining 13 vessels sold are still moored in MARAD's Fleet, requiring continued maintenance at U.S. Government expense.



Between 1991 and 1994, MARAD sold 80 vessels overseas for scrapping at an average price of \$433,000 per vessel. During the past year, vessel sales yielded between \$10 and \$105 per vessel. On October 25, 1999, MARAD sold three vessels for \$10 per vessel. The most recent sale was for two vessels at \$105 per vessel on December 21, 1999.

LOSS OF OVERSEAS MARKETS CONTRIBUTED TO THE DECLINE IN SCRAPPING

MARAD suspended the sale of vessels to overseas scrappers in 1994 because the EPA prohibited the export of Government-owned ships containing PCBs. In September 1998, an Administration moratorium halted all sales of Government-owned vessels for scrapping overseas. The moratorium expired on October 1, 1999, but MARAD has refrained from exporting vessels overseas for scrapping.

Based on a 1997 agreement between MARAD and EPA, MARAD is required to request EPA's approval to sell vessels to overseas contractors that can scrap them in an environmentally compliant manner. The agreement requires MARAD to ensure that all liquid PCBs in transformers, capacitors, hydraulic and heat transfer fluids and that all "readily removable" solid PCBs are removed prior to exporting these vessels. This agreement also requires EPA to notify countries of import that they will be receiving vessels and that these vessels may contain PCBs. To date, MARAD has not requested EPA approval to sell any of its vessels awaiting

disposal to overseas scrappers. However, on April 14, 2000, the Maritime Administrator sent a letter to the EPA requesting its assistance on developing an option for exporting vessels for scrapping and implementation of the 1997 EPA/MARAD agreement.

LIMITED DOMESTIC CAPACITY HAMPERS PROGRESS IN SCRAPPING

Since 1995 MARAD has been relying on the domestic market, but capacity in the domestic market is limited. In the 1970s, there were 30 U.S. contractors in the ship scrapping industry. Over the past 19 months, however, only four companies have bid on MARAD's scrapping contracts and passed MARAD's technical compliance review to scrap vessels. These four companies can only handle approximately one to five vessels at a time, depending on the size of the scrap yard and the dimensions of the vessel. For example, one company could only scrap two or three vessels per year. According to industry sources, it takes approximately 4 to 6 months to completely scrap a MARAD vessel.

Additional companies are not attracted to this industry because of the low profits currently available. Scrap steel prices in the United States are low and contractors must comply with environmental regulations. Most of the domestic scrapping company officials we contacted indicated that the profit from scrapping vessels is not worth the effort. At a minimum, contractors in this business must pay for the

towing costs and provide \$150,000 as a performance bond to secure a vessel after a contract has been awarded. Contractors receive no return on a vessel until scrap metal and the equipment removed from the vessel are sold.

Even when it has been able to sell vessels, MARAD has encountered problems with domestic contractors. In 1999, MARAD sold 17 vessels to 3 ship scrapping companies located in Brownsville, Texas. At the time of our review, we found that only two companies were actively scrapping ships, and only one of these companies was currently scrapping a MARAD ship. MARAD has granted a number of extensions to contractors, and in one instance, MARAD had to resell vessels because of contractor default. During our review, we also found that another company had not taken possession of any vessels because of an ongoing dispute with the Port of Brownsville regarding contamination of its scrapping site. It has since taken possession of its vessels.

NAVY PILOT PROJECT POSES COMPETITION FOR MARAD

The Department of the Navy experienced a similar inability to sell its combatant vessels for domestic scrapping. In 1998, Congress authorized and appropriated funding for a Navy pilot project for the disposal of obsolete warships. The Navy and MARAD are coordinating efforts to improve ship scrapping programs, as recommended by the Interagency Panel on Ship Scrapping and the General

Accounting Office. The Navy agreed to share its findings from the pilot project with MARAD.

On September 29, 1999, the Navy awarded four cost-plus contracts totaling \$13.3 million for the scrapping of four vessels under its new Pilot Ship Disposal Project. This pilot project departs from the sales contracting process by providing for cost plus incentive fees for scrapping the first vessels. It guarantees profitability by providing for the cost of scrapping the vessels and gives the contractor the opportunity to earn incentive fees, which encourages and rewards superior contractor performance. If the contractors are successful in scrapping the first 4 vessels, they will be given the opportunity to scrap more vessels, potentially leading to the disposal of 66 warships.

One of these contractors was also under contract with MARAD to scrap its vessels. The company completed scrapping four MARAD vessels during 1998 and 1999; however, it defaulted on a contract for another five MARAD vessels in August 1999.

MARAD cannot compete with the Navy's pilot project while it is required by law to maximize financial return on its vessels. If MARAD were authorized to implement such a project, it could cost as much as \$515 million to dispose of the obsolete vessels that MARAD expects to have by the end of FY 2001.

ALTERNATIVES OFFER POTENTIAL BUT HAVE LIMITATIONS

While MARAD has been pursuing ways to improve scrapping sales, its ability to explore creative solutions for disposing of vessels is constrained by the requirement to maximize financial returns. Also, the alternatives MARAD is pursuing have capacity limitations, so no one single option has the potential to significantly reduce the backlog of vessels awaiting disposal in a timely manner. We have identified additional alternatives that MARAD has not pursued that may have the potential to contribute to the goal of disposing of obsolete vessels.

Programs to improve scrapping sales and alternatives MARAD is pursuing include: coordination with the Navy and a west coast company on a proposal for a potential scrapping site; participation in interagency work groups to look for innovative ways to improve the ship scrapping process and establish consistent procedures; donation of vessels designated for disposal for uses such as museums and the fish reef program, given legislative or executive approval; and coordination with the Navy on its program to sink vessels in deep water after hazardous materials are removed.

MARAD may be able to explore alternatives that have the potential to assist in disposing of some of its vessels such as: selling vessels to other countries for non-military uses, given legislative approval and approval from the EPA to sell vessels

to overseas markets that are capable of scrapping them in an environmentally compliant manner.

According to MARAD, selling vessels overseas for non-military uses would require a change in the law that only allows MARAD to sell vessels for disposal or non-transportation use. However, legislation was passed in 1996 for four vessels to be sold on a competitive basis for operational use. One vessel was sold in 1999 and bids on two vessels are currently under review. The fourth vessel requires an EPA approval, which MARAD requested April 1999.

On April 14, 2000, MARAD sent a memorandum to EPA requesting its assistance in facilitating an export option for scrapping based on the 1997 EPA/MARAD agreement. MARAD also said it would contact the EPA staff to discuss recommendations made by the Interagency Panel on Ship Scrapping.

DISPOSAL PLAN AND PROMPT ACTION ARE NEEDED

The National Maritime Heritage Act of 1994 requires MARAD to dispose of its obsolete vessels by the end of FY 2001, which is an extension from 1999, the original deadline. MARAD does not have a plan to dispose of these vessels.

In our March 10, 2000 audit report, MA-2000-067¹, we recommended that the Maritime Administrator:

1. Seek legislative approval to extend the 2001 mandate to dispose of obsolete vessels and to eliminate the requirement that MARAD maximize financial returns on the sale of its obsolete vessels.
2. Continue to pursue programs to improve scrapping sales and identify alternative disposal methods that can contribute to the goal of reducing the number of obsolete vessels awaiting disposal, to include working with the Navy on the results of its studies on the environmental impact of sunken vessels.
3. Develop a proposal for submission to Congress seeking approval and funding for a project to pay contractors for vessel scrapping. The proposal should include a plan to target the “worst condition” vessels first, identify funding and staffing requirements, and provide milestone dates to dispose of all obsolete vessels.

MARAD concurred with our recommendations. In its FY 2001 authorization request, MARAD proposed a “five year extension [in the deadline that] will

¹ Report on the Program for Scrapping Obsolete Vessels, MARAD, March 10, 2000.

provide MARAD with additional time to develop and begin implementing a plan to dispose of these vessels.” Considering the condition of some of the vessels, the environmental risks, and the costs to maintain them, we find the MARAD proposal unacceptable. **MARAD must develop and implement a disposal plan** for its obsolete vessels once legislative approval is obtained for an extension.

As a part of its disposal plan, MARAD must state specific milestones and steps it will take to scrap its obsolete vessels within the next 5 years. The plan must state how MARAD proposes to dispose of these vessels taking into consideration all the available options. MARAD must identify viable disposal methods, and target the “worst condition” vessels for priority disposal.

Mr. Chairman, this concludes our statement. I would be pleased to answer any questions.

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